

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of

**BellSouth Telecommunications, Inc.
Tariff FCC No. 1, Transmittal No. 657**

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) **WC Docket No. 02-304**
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**DECLARATION OF BRADFORD CORNELL
ON BEHALF OF AT&T CORP.**

I. BACKGROUND AND QUALIFICATIONS

1. My name is Bradford Cornell. I am a senior consultant to Charles River Associates (CRA), an international consulting firm. In my position as senior consultant, I advise business and legal clients on a range of financial economic issues. I am also a Professor of Finance and Director of the Bank of America Research Center at the Anderson Graduate School of Management at the University of California, Los Angeles (UCLA). Additionally, I have taught at the UCLA Law School.

2. I earned a master's degree in Statistics from Stanford University in 1974 and earned my doctorate in Financial Economics from Stanford in 1975. I have served as an editor of numerous journals relating to business and finance and have written more than 70 articles and two books on finance and securities markets.

3. Prior to my affiliation with CRA, which began in March of 1999, I operated FinEcon, a financial economic consulting company, through which I also advised business and legal clients on financial economic issues. I have served as a

consultant and given testimony for both plaintiffs and defendants in a variety of securities, regulatory and commercial litigation.

4. During my many years of experience as an expert witness and consultant, I have performed numerous analyses in matters involving telecommunications companies. For example, I have testified before state regulatory commissions in UNE cost proceedings and have testified before the FCC in an access charge rate of return proceeding. I have also performed analyses of the broadband industry, have served as a special master in a dispute over the valuation of a Russian wireless franchise, and have evaluated the impact on ratepayers of the spin-off of a wireless subsidiary from a regional Bell operating company (RBOC). My background is described more fully in my *curriculum vitae*, which is attached as Exhibit 1.

II. SCOPE OF OPINIONS AND ANALYSIS

5. Counsel for AT&T Corp. ("AT&T") have asked me to respond to assertions made in the Direct Case dated October 10, 2002 filed by BellSouth Telecommunications, Inc. ("BellSouth") regarding proposed modifications to the customer deposit provisions of BellSouth's interstate access tariff. These modifications in part provide that:

- a. BellSouth would use Moody's RiskCalc and Dun & Bradstreet's Risk Assessment Manager ("RAM") software in determining whether a particular interstate long-distance customer should be required to provide a security deposit.
- b. BellSouth would require deposits of those customers who scored worse than "5" through either of these models and would reserve the

discretionary right to demand deposits of customers that scored better than 5.¹

- c. Deposits would also be required for new customers, customers “with a proven history of late payments,” customers without established credit, and customers whose “gross monthly billing has increased as compared to the billing level used to determine the initial security deposit.”²
- d. The deposit could be in the form of cash, a security interest in tangible assets, or a surety bond.³
- e. Deposits could be as high as the total of two full months’ worth of estimated billings for interstate long distance services based on an average of the most recent three months of undisputed charges.⁴
- f. BellSouth would not review their credit assessments more frequently than once a year and could conceivably wait longer than a year to perform a credit review.

6. I find BellSouth’s proposed modifications to the customer deposit provisions to be unreasonable and severely anticompetitive, for two primary reasons. *First*, BellSouth’s tariff modifications, which provide it with far more latitude in demanding security deposits from its customers, are entirely unnecessary. Although the telecommunications industry has certainly experienced stock market declines, and some

¹ In the matter of BellSouth Telecommunications, Inc., Tariff FCC No. 1, Transmittal No. 657, Direct Case dated October 10, 2002, p. 14, ¶ 31.

² *Id.* p. 3, ¶ 5.

³ Direct Case at p. 11, ¶ 23.

⁴ Order at p. 4, ¶ 8.

competitive local exchange carriers and interexchange carriers have filed for bankruptcy, the impact of those factors on BellSouth's bad debt expense has been limited. Moreover, BellSouth has provided no legitimate evidence showing that the recent modest increases in its uncollectible bad debt are permanent. To the contrary, economic logic and historical evidence suggest that BellSouth's bad debt expense is related to current economic conditions and is therefore cyclical. Further, even these slight cyclical increases in uncollectibles have had no measurable impact on BellSouth's profits for access services, which remain quite high. For these reasons, any changes to existing provisions on BellSouth's ability to collect security deposits are unwarranted.

7. *Second*, even if BellSouth needed to collect additional security deposits, the methods it proposes to determine which access customers must pay these deposits provide BellSouth with complete discretion. That discretion is dangerous, because BellSouth has strong incentives to use that discretion to favor its affiliated companies. By demanding large security deposits from its access customers (but not its own long distance affiliate), BellSouth can directly raise its rivals' costs, thereby providing BellSouth's affiliates with a distinct competitive advantage. Additionally, unlike companies in competitive industries, BellSouth's decisions about security deposits are not disciplined by the market, because BellSouth's access customers generally cannot switch to another supplier. Thus, there is virtually no check on BellSouth's discretion, which, as noted, it has every incentive to abuse.

A. BellSouth Does Not Need To Collect Additional Security Deposits.

8. The Investigation Order in this proceeding required BellSouth to demonstrate that its bad debt expense has increased because of some long-term trend,

rather than any short-term circumstance. According to the FCC's Order adopted

September 18, 2002, BellSouth:

shall . . . address whether the variation in uncollectible levels for 2000 and 2001 is merely a normal fluctuation in uncollectibles, which would be covered by the business risks anticipated to be endogenous to price caps, or whether it reflects some long term trend that warrants expanded security deposits from customers meeting BellSouth's proposed standards.⁵

Even though the FCC squarely puts the burden of proof on BellSouth, BellSouth has not addressed this issue in its Direct Case. It has not stated whether it believes that the increased level of uncollectibles is permanent, or what it predicts the level of uncollectibles will be in the future. If it does believe that the level of uncollectibles has in fact risen to significantly higher permanent levels, it has not provided any evidence to support such a proposition.

9. First, there is no evidence that BellSouth has experienced a permanent bad debt increase with respect to its access customers. Exhibit 2 shows annual uncollectible receivable expense for BellSouth and eleven other major LECs as a percentage of wholesale revenue. That data on its face does not show that BellSouth has experienced any permanent increase in uncollectible accounts receivable. For example, BellSouth's uncollectibles percentage was .24% in 1990, but was .15% in 1993. By 1997, it had risen to 1.05%, but fell to .35% in 1999. As can be seen in Exhibit 2, increases in BellSouth's uncollectibles percentage from 1990 through 1997 have also been followed at some point by decreases in the uncollectibles percentage. If in 1998 BellSouth had used its more than six-fold increase in percentage uncollectibles between 1993 and 1997 to argue that its uncollectible receivables had increased permanently as a percentage of revenues,

⁵ *Id.* at p. 5, ¶ 11.

it would have been wrong. Recent fluctuations, like past fluctuations, are more than likely caused by normal changes in the business cycle or other short-term circumstances.

10. In this regard, in comparison to other LECs, BellSouth's 2001 uncollectible wholesale accounts receivable as a percentage of wholesale revenue was the highest in the group at 1.46%. Verizon-East was the second highest in the group at 1.36%. However, the average uncollectibles of the group, excluding BellSouth and Verizon-East, was far lower, coming in at 0.53%. The average for the group overall was 0.69%, still much lower than that experienced by BellSouth in 2001. For the year 2000, the overall group average was 0.42%, and was 0.37% without Verizon-East and BellSouth. Thus, in 2001, BellSouth was not experiencing uncollectible expenses from wholesale interstate long distance revenue that were consistent with bad debt losses experienced by other LECs.

11. Such evidence further discounts any assertion that BellSouth is now subject to a permanent increase in the magnitude of its bad debt, because other LECs have experienced lower levels of bad debt expense in the same time frame. BellSouth's relatively higher level of bad debt expense may be due to circumstances that it directly controls. For example, it may be less efficient at collecting bad debts once its customers default, or it may not be as skilled as other LECs in identifying the customers that qualify for security deposits under the existing and more limited provisions.

12. Second, as a matter of practical economics, the revenues of the long-distance business derive from the phone calls made by business and consumer customers. From the point of view of the ILECs, their access revenues ultimately depend upon the dollar-generating calls made by these end user customers, even though IXC's are

generally the direct purchasers of access services. While the number of such IXC's purchasing access may expand and contract over time, the call-generating public remains the source of revenues. Consequently, for BellSouth to demonstrate successfully that there has been a permanent increase in bad debts by its long-distance access customers, it would also have to show that the financial reliability of the IXC's own customers as a whole has permanently declined. There is simply no evidence that could support such an assertion. The ability of IXC purchasers to pay their debts may vary over time in conjunction with business cycles, but there is no reason to believe that such customers have suffered permanent financial impairment.

13. BellSouth, in part, grounds its need for higher security deposits on an assertion that over the past two years unpaid access charge accounts receivable have increased because of companies that are now in bankruptcy. Even if this assertion was assumed to be true for argument's sake, bankruptcy losses— which arise from the current recession (and, in some cases, apparent fraud) — lead to the conclusion that, by definition, they will not be occurring in the future. To the extent that the increase in uncollectible receivables arises from companies that have filed for bankruptcy, such an increased level is a temporary fluctuation.

14. Moreover, many of these bankrupt companies will more than likely cease to exist. The customers that used them, however, will migrate the calls that terminate on the BellSouth network to more viable companies. Given the downturn in the telecom industry, which BellSouth has itself noted, the likelihood of new and financially unstable long distance companies now entering the business and handling these calls is low. The likelihood that long-distance customers will migrate to the financially more stable

survivors, which will be more reliable in paying bills owed to BellSouth, is high. In short, as the business cycle eliminates the less efficient companies from the market, BellSouth will likely have an *easier*, not a more difficult, time collecting its receivables in the future.

15. Lastly, even assuming some temporary increase in bad debt expense, it is difficult to understand why BellSouth needs to collect additional security deposits, given that its rates of return for its access services have remained high over the last several years, and are extremely high by virtually any standard. BellSouth is an ILEC operating under price cap regulation. According to the most recent rate of return that the FCC determined to be reasonable for BellSouth and other incumbent local exchange carriers, such a price cap carrier was expected to earn an interstate rate of return of about 11.25%. However, BellSouth has earned interstate returns on access of 18.34% in 1999, 20.69% in 2000, and 19.41% in 2001, and much higher returns on special access, despite increases in uncollectible accounts receivable in those years. See Exhibit 3.

16. Thus, during a period of time that it asserts is economically unstable and volatile for many of its access customers, BellSouth has been earning well above expected returns on its investment. It seeks, however, to have its IXC access customers, which are also its interstate long-distance service competitors, bear its risk of uncollectible accounts receivable. This is an inappropriate redistribution of risk. As a company subject to price cap regulation, BellSouth bears the business risks associated with the potential for any excess profits that it could earn, and these business risks include the potential for uncollectible receivables associated with those profits.

B. BellSouth Has Complete Discretion To Impose Security Deposits, And There Is No Serious Check To Prevent BellSouth From Abusing That Discretion.

17. Even if BellSouth had demonstrated that it needed to secure more of its access revenues with large deposits, the method it proposes to determine when to demand such deposits is very troubling and appears anticompetitive. According to its Direct Case, BellSouth's use of RiskCalc and RAM software requires historical financial inputs to ascertain a customer's likelihood of default. Moreover, as declarations that AT&T is submitting in this case explain, in order to utilize these software programs, a company like BellSouth would customize the programs to account for certain financial information and desired weighting of particular factors. These programs, therefore, provide BellSouth with a tremendous amount of discretion in determining whether to demand a security deposit from an access customer.

18. In its proposal, BellSouth would have the right to make these subjective decisions for its customers. In addition, BellSouth has stated that it will consider current information that would negate a poor RAM or RiskCalc score or, conversely, new information that would override good scores and be taken into account by BellSouth's credit managers.⁶ This ability to "bend the rules," supposedly provided by the credit scores, adds a whole new layer of subjectivity that cannot be audited effectively by outsiders.

19. The use of subjective judgment has considerable potential for abuse as BellSouth considers the creditworthiness of its long-distance competitors and affiliates both in determining historical asset classification and in considering more recent

⁶ Direct Case, p. 14, ¶ 31.

information, such as payment history. This is a particularly sensitive issue because wholesale customers that are required to make deposits are at a competitive disadvantage to those that are not required to make such deposits.

20. Moreover, the discretion is particularly troubling for competition because it would provide BellSouth with a direct ability to raise its rivals' costs. BellSouth, like other ILECs, has its own long-distance affiliate. According to its Direct Case, this affiliate is sufficiently creditworthy such that BellSouth would not require a deposit when the affiliate is scored by the RAM credit rating program.⁷

21. As an initial matter, BellSouth's conclusion that its own subsidiary would be creditworthy is immediately suspect. In theory, BellSouth's IXC company is a fledgling startup, unsupported by either BellSouth's profitable LECs or the BellSouth Corporation parent. It is my understanding that BellSouth's affiliate is required to compete on a stand-alone basis with other IXCs so as not to give it an unfair advantage in the ILEC's service territory. For example, as I understand it, under the Telecommunications Act, the affiliate may not obtain credit under any arrangement that would permit the affiliate's creditors to have recourse to BellSouth's assets.⁸

22. According to BellSouth's stated concerns, the affiliate is precisely the kind of company that poses significant credit risk. BellSouth has not shown how it arrived at its credit scores for its IXC affiliate. Its unlikely conclusion, however, highlights the problems of subjectivity inherent in these types of credit assessment models. Without careful analysis of the underlying data and the models themselves, one cannot ascertain

⁷ *Id.* at n. 17.

⁸ *See* 47 U.S.C. §272(b)(4).

whether or not BellSouth is rating its affiliate using its scoring programs in such a way as to give it an unfair advantage over competing IXC's.

23. Moreover, through the use of its wide discretion, BellSouth is able to require its rival IXC's to provide large deposits for access revenues, while exempting its own long distance affiliate's operations from the same requirement. That is an instance of raising rivals' costs that poses serious competitive concerns.

24. Even more troubling is that there is virtually no check on BellSouth's discretion to demand security deposits. Although BellSouth claims it wants to implement credit practices that are prevalent throughout other industries, the credit practices of companies in other competitive industries are subject to market discipline. If such a company demands a security deposit from a customer, it risks losing that customer's business, because the customer may be able to seek out another supplier that offers more favorable credit terms. These market forces provide a powerful incentive for companies in competitive industries to make reasonable credit demands and limit security deposit requests to exceptionally risky customers.

25. BellSouth, by contrast, has no such check on its deposit decisions. Its access customers generally have no choice but to purchase service from BellSouth. In that instance, BellSouth has no incentive to make reasonable credit determinations. In fact, it has every incentive to make an *unreasonable* credit determination, precisely because such decisions can raise its rivals' costs. For these reasons, BellSouth's credit scoring proposals are anticompetitive.

26. Other provisions proposed by BellSouth have very similar anticompetitive consequences. According to its Direct Case, BellSouth asserts that it:

cannot, due to resource constraints, obligate itself to reviewing [sic] every customers' [sic] credit on an annual basis. Further, as all behavior that dictates a customer's creditworthiness is in the hands of the customer, the customer is the best resource as to determine when creditworthiness has improved. It should be the customer's obligation to inform the supplier of a positive change in its creditworthiness status. BellSouth is ready, willing and able to respond to a customer's request to review its credit standing. The review will be swift, nondiscriminatory and in accordance with the same factors utilized to establish creditworthiness initially.⁹

Thus, BellSouth can, on its own, review an interstate long-distance wholesale customer's creditworthiness using a large number of subjective factors as described above, require a security deposit equal to two months' estimated billings, require the ongoing maintenance of this deposit, and not review the customer's creditworthiness on an annual basis unless the customer so requests. Even if the customer requests such a review, it is unclear from BellSouth's Direct Case how long it will take for BellSouth's credit managers to complete the review and render a decision. Because BellSouth's wholesale long-distance termination customers are also competitors of its long-distance affiliate, BellSouth has an undeniable economic incentive to require the maximum deposits of all its wholesale customers, and take as long as possible in reviewing such customers' creditworthiness if and when a review is requested. This particular provision of BellSouth's tariff modification request has considerable potential to harm competition in the interstate long-distance sector of BellSouth's service territory.

27. According to the September 18, 2002 FCC Order, BellSouth's current security deposit policy allows it to collect deposits from carriers with a proven history of late payments to it and those carriers without established credit.¹⁰ BellSouth's Direct

⁹ Direct Case at pp. 15-16, ¶ 34.

¹⁰ Order, p. 2, ¶ 2.

Case contends that “[u]nder the existing deposit provisions, BellSouth holds \$16,292,704 in deposits for intrastate and interstate access. These deposits compare to monthly charges of \$297,548,522 or 5.5 per cent of monthly revenues.”¹¹ Thus, BellSouth would appear to hold more than sufficient deposits on two groups of customers that would be among the greatest risks for non-payment of receivables.

28. Finally, in Exhibit 2 of its Direct Case, BellSouth points out that 89 percent of its interstate billings that were billed from the Carrier Access Billing System for the year to date 2002 were billed in advance.¹² This means that there is already the equivalent of a one-month deposit with respect to a substantial proportion of current Carrier Access Billing System Billings.

Conclusions

29. The proposed modifications to its tariff agreement that BellSouth seeks with respect to wholesale interstate long-distance customer deposits have not been proven to be necessary, are severely flawed, and appear to be designed to economically disadvantage competitors.

- BellSouth has failed to show that a recession-induced increase in its interstate long-distance wholesale uncollectible receivables is permanent.
- An analysis of uncollectible wholesale interstate long-distance termination receivables as a percentage of revenues for BellSouth and other LECs shows that percentage uncollectibles fluctuated and were volatile over the

¹¹ Direct Case, p. 8, n.8.

¹² Direct Case, Exhibit 2.

period 1990 to 2001. There was no trend evident indicating a permanent increase in uncollectibles either for BellSouth or for LECs in general.

- BellSouth has also earned above-expected rates of return on its invested assets during the period of which it complains, even when these uncollectible amounts are taken into account.
- Because BellSouth is subject to price cap regulation, it should bear the business risks of any potential excess profits it can generate.
- BellSouth's credit scoring proposals would give it nearly unfettered discretion. This could lead to considerable discrimination on BellSouth's part against the IXC wholesale customers that are also its interstate long-distance competitors.
- BellSouth's unwillingness to review credit assessments with frequent regularity highlights both the potential for discrimination against competitors, and the degree of difficulty—and potential subjectivity—associated with performing the credit analyses.
- BellSouth already has deposits equaling 5.5 percent of monthly interstate and intrastate revenues for those customers with prior payment problems or no established credit history. These deposits should afford substantial protection against the risks of non-payment on a forward-looking basis, given the consolidation that has occurred in the telecom industry.
- BellSouth already bills the vast majority of its carrier access charges in advance, which effectively gives it a substantial one-month security deposit, even from customers with strong credit standing.

VERIFICATION PAGE

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

/s/ Bradford Cornell

Bradford Cornell

Executed on October 24, 2002.

Exhibit 1

BRADFORD CORNELL—*Professor of Financial Economics, Anderson
Graduate School of Management, UCLA*

Ph.D. Financial Economics, Stanford University, 1975
M.S. Statistics, Stanford University, 1974
A.B. (Interdepartmental) Physics, Philosophy and Psychology, Stanford
University, 1970

ACADEMIC AND PROFESSIONAL POSITIONS

1987–Present: Professor of Finance and Director of the Bank of America Research Center,
Anderson Graduate School of Management, UCLA

1990–1999: President, FinEcon: Financial Economic Consulting

1988–1990: Vice-President and Director of the Securities Litigation Group, Economic
Analysis Corporation

1979–1986: Assistant and Associate Professor of Finance, UCLA

1983–1984: Visiting Professor of Finance, California Institute of Technology

1977–1979: Assistant Professor of Finance, University of Southern California

1975–1977: Assistant Professor of Finance, University of Arizona

COURSES TAUGHT

Corporate Valuation
The Law and Finance of Corporate Acquisitions and Restructurings
Corporate Financial Theory
The Theory of Finance (in the UCLA Law School)
Security Valuation and Investments
A wide variety of executive and community education programs

SPECIAL EDUCATION PROGRAMS INCLUDE

The U.S. Business School in Prague—Special Finance Program, Summer 1991
The Nissan Program for Historically Black Colleges, Director, Summer 1989
The Lead Program for Business Education of Minority High School Students, 1987–Present

CONSULTING AND PROFESSIONAL ACTIVITIES

SELECTED SERVICE AT UCLA

Twice Chairman of Finance Department



BRADFORD CORNELL—Page 2

Twice Vice Chairman of the Anderson School
Three-time member of the staffing and promotion committee

SERVICE TO SCHOLARLY JOURNALS AND ORGANIZATIONS

Served as an associate editor for a variety of scholarly and business journals including: *Journal of Finance*, *Journal of International Business Studies*, *Journal of Business and Economics*, *Journal of Financial Research*, *Journal of Futures Markets*, and the *Investment Management Review*.

Served as a reviewer for numerous finance and economics journals including: *American Economic Review*, *Journal of Political Economy*, *Journal of Financial Economics*, *Journal of Business*, *Journal of Financial and Quantitative Analysis*, and the *Review of Economics and Statistics*.

MEMBERSHIPS IN PROFESSIONAL SOCIETIES

American Finance Association: 1973–Present
Member of Board of Directors: 1987–1989
Western Finance Association: 1973–Present
Member of Board of Directors: 1982–1985
Vice President: 1987
American Economic Association: 1973–Present
American Bar Association: 1995–Present
American Statistical Association: 1992–Present
International Association of Financial Engineers: 1993–Present
American Law and Economics Association: 1995–Present
Human Behavior and Evolution Society: 1995–Present

RESEARCH EVALUATION

Project reviewer for the National Science Foundation: 1979–Present
Program committee for the Western Finance Association: 1982–1988

SELECTED BOARD AND COMMITTEE MEMBERSHIPS

Chairman, Mayor Riordan's Blue Ribbon Commission on Los Angeles' Municipal Investments
Pension Policy Board, The Aerospace Corporation: 1985–Present
Forms Engineering Corporation: 1976–1997
Trustee, Kellow Trust: 1982–1991

SELECTED CONSULTING CLIENTS

Merrill Lynch (obtained futures broker's license, owned a seat on the International Monetary
Market of the Chicago Mercantile Exchange)
Chase Manhattan Bank
Thrifty Corporation
Wynn Oil



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Resorts International

EXPERT WITNESS

Numerous cases involving the application of financial economics

MEDIA EXPERIENCE

Occasional contributor to *The Wall Street Journal* and *The Los Angeles Times*

Occasional commentator for local television and radio stations

Lecturer on valuation theory, appraisal practice, and securities pricing

PUBLICATIONS

Books

Cornell, B., 1999, *The Equity Risk Premium and the Long-run Future of the Stock Market*, John Wiley and Sons, New York, NY.

Cornell, B., 1994, "Corporate Valuation," in *Handbook of Modern Finance*, 3rd edition, Dennis Logue, ed., Warren Gorham Lamont, Boston, MA.

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ACADEMIC ARTICLES

Cornell, B. and W. Landsman, 2002, "Accounting and Valuation: Is the quality of earnings an issue?" *Financial Analysts Journal*, forthcoming.

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Cornell, B. and K. Green, 1991, "Measuring the Investment Performance of Low-grade Bond Funds," *Journal of Finance*, 66 (March): 29–48.

Cornell, B. and G. Morgan, 1990, "Using Finance Theory to Measure Damages in Fraud on the Market Cases," *UCLA Law Review*, 37 (No. 2): 883–924.

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Exhibit 2

Exhibit 2

Interstate less End-user Uncollectibles as Percent of Interstate less End-user Revenues

	Ameritech	BellSouth	Citizens*	Iowa Telecom*	Pacific Bell	Nevada Bell
1990	0.43%	0.24%	1.61%	0.20%	0.31%	0.13%
1991	0.53%	0.30%	2.19%	1.09%	0.22%	0.14%
1992	0.45%	0.28%	1.23%	-0.48%	0.24%	0.27%
1993	0.51%	0.15%	1.58%	0.56%	0.17%	0.20%
1994	0.68%	0.38%	0.89%	0.53%	0.15%	0.18%
1995	0.29%	0.40%	0.59%	0.17%	0.18%	0.15%
1996	0.60%	0.83%	0.63%	0.39%	0.21%	0.18%
1997	0.26%	1.05%	0.64%	0.53%	0.31%	1.13%
1998	0.40%	0.43%	0.40%	0.48%	0.08%	0.43%
1999	0.16%	0.35%	0.52%	0.75%	0.21%	0.31%
2000	0.11%	0.74%	0.48%	not available	0.19%	0.22%
2001	0.11%	1.46%	0.59%	not available	0.23%	0.28%

	Qwest	Southern New England Telephone	Sprint*	Southwestern	Verizon East	Verizon West
1990	0.36%	0.14%	0.18%	0.45%	0.38%	0.35%
1991	0.58%	0.52%	0.15%	0.30%	0.25%	0.84%
1992	0.52%	0.48%	0.05%	0.32%	0.33%	0.91%
1993	0.41%	0.26%	0.22%	0.35%	0.51%	0.54%
1994	0.45%	0.23%	0.05%	0.30%	0.67%	0.52%
1995	0.56%	0.16%	0.23%	0.26%	0.58%	0.77%
1996	0.59%	0.41%	0.15%	0.29%	0.50%	0.51%
1997	0.58%	0.93%	0.21%	0.29%	0.40%	0.52%
1998	0.92%	0.32%	0.23%	0.31%	0.35%	0.54%
1999	0.74%	0.26%	0.20%	0.41%	0.35%	1.05%
2000	0.18%	0.25%	0.39%	0.76%	0.49%	0.78%
2001	0.45%	0.48%	0.77%	1.12%	1.36%	0.77%

* No End-user data available. Percentages based on Interstate data only.

Data Sources Used to Calculate Percentages: ARMIS Reports 43-01 and 43-02

Exhibit 3

RBOC Interstate Earnings

	<u>Avg Net Investment *</u>	<u>Net Return **</u>	<u>Rate of Return</u>
<u>BellSouth</u>			
1997	4,761,659	784,700	16.48%
1998	4,694,980	841,675	17.93%
1999	4,941,823	906,349	18.34%
2000	5,315,088	1,099,428	20.69%
2001	5,878,471	1,140,874	19.41%
<u>Qwest</u>			
1997	3,865,936	583,536	15.09%
1998	3,725,083	604,050	16.22%
1999	3,842,608	745,917	19.41%
2000	4,271,934	861,903	20.18%
2001	4,752,456	1,051,736	22.13%
<u>SBC</u>			
1997	9,631,804	1,297,272	13.47%
1998	9,482,894	1,473,017	15.53%
1999	9,317,047	1,758,596	18.88%
2000	10,103,928	2,119,427	20.98%
2001	11,565,699	2,586,020	22.36%
<u>Verizon (North+South+GTE)</u>			
1997	12,283,778	2,028,559	16.51%
1998	12,865,280	1,994,088	15.50%
1999	13,450,002	2,339,833	17.40%
2000	14,388,378	2,480,784	17.24%
2001	15,201,546	2,596,471	17.08%
<u>Verizon (excl. NYNEX)</u>			
1997	8,541,524	1,519,974	17.80%
1998	8,886,551	1,531,316	17.23%
1999	9,267,436	1,919,967	20.72%
2000	9,662,367	2,073,302	21.46%
2001	10,074,982	2,213,353	21.97%

Note:

* - 1997-2001 ARMIS 43-01, Table I. Cost and Revenue Table, Interstate, Column (h), Average Net Investment, Row 1910.

** - 1997-2001 ARMIS 43-01, Table I. Cost and Revenue Table, Interstate, Column (h), Net Return, Row 1915.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D. C. 20554**

In the Matter of)
)
)

BellSouth Telecommunications, Inc.)
Tariff F.C.C. No. 1, Transmittal No. 657)
_____)

WC Docket No. 02-304

DECLARATION OF RAYMOND E. BLATZ

1. My name is Raymond E. Blatz. My business address is 200 South Laurel Avenue, Middletown, New Jersey 07748.

2. I am currently employed by AT&T Business Services as a Division Manager, in the Revenue Assurance Management Organization. I have spent my entire six-year career with AT&T working on revenue assurance and uncollectible expense issues. One of my responsibilities in that position is overseeing and managing the processes used by AT&T to assess whether AT&T should collect deposits from its customers.

3. Prior to joining AT&T in 1996, I held various positions relating to credit analysis and collections for other large firms, including, Sara Lee, Block Drug, Digital Equipment, American Express and Household Finance. I have a B.A. from Jersey City State College, and an M.B.A. from Pace University. I also am a Certified Management Accountant and a Member of the Board of Directors of the National Telecommunications Data Exchange.

4. The purpose of my testimony is to dispute BellSouth's claims that it is industry practice to impose substantial deposit requirements on large customers that receive a poor

credit score from one or two credit scoring tools. I also demonstrate that, based on my communications with a Dun & Bradstreet representative, the Dun & Bradstreet Risk Assessment Manager ("RAM") credit scoring tool is not an objective tool. Rather that credit scoring tool is highly customizable, and in many cases *requires* customized inputs. And those customized inputs can have a substantial impact on the credit score produced by that credit scoring tool.

5. I understand that BellSouth has stated and implied that it is commercially acceptable to impose large deposit requirements on carriers that receive poor credit scores from one or two credit scoring tools. That is nonsense. As noted, I have worked in the risk assessment departments in numerous large companies, and have worked for the past six years in AT&T's Revenue Assurance Management organization. Based on that experience, I can confirm that it is very rare for corporations to impose large deposit requirements on customers based solely on customers' credit scores from one or two credit scoring tools. Moreover, I am unaware of *any* instance in which a deposit requirement of *hundreds of millions of dollars* was imposed on a large company based solely on one or two credit scoring tools.

6. To be sure, companies will from time to time employ some type of credit scoring tool (though not necessarily the programs proposed by BellSouth) when assessing whether to charge customers sizable deposits. However, credit scores are hardly determinative. Other factors, including the customers' financial records and historical payment records, play an important role in determining whether to impose large deposits on customers. In competitive industries where customers have the choice to leave a vendor that makes unreasonable deposit demands, it is critical for each competitor to accurately

assess payment risk, and to impose a deposit requirement only if it is confirmed that there is in fact a substantial risk that the customer will not pay its bills in the future. Charging deposits to customers that have a strong history of payment and sound financial books – even if that customer has a low credit score from one or two credits scoring tools – likely would result in losing that customer's business to a competitor that does not charge unnecessary deposits.

7. Notably, the documentation provided by BellSouth relating to the Moody's RiskCalc credit scoring tools confirms that my experience is consistent with how the creators of credit scoring tools expect their products to be used. As explained by Moody's:

Like all new technologies, RiskCalc is a supplement to, not a substitute for, good judgement. Many factors not reflected in balance sheets and income statements are relevant to gauging loan risk. The score produced by RiskCalc alone cannot answer the deeper question as to whether the credit adds value from a portfolio relationship perspective. However, what RiskCalc can do is efficiently summarize on portion of the problem (financial statements) so that an analyst can focus her expertise more productively.¹

8. Thus, to the extent that BellSouth states or implies that it is common commercial practice to rely on one or two credit scoring tools to impose substantial deposit requirements on customers, BellSouth is wrong.

9. I also understand that BellSouth has asserted that the credit scoring tools it proposes are an objective method for assessing risk. That also is false. I understand that BellSouth provides the credit scores that, according to BellSouth, the BellSouth Corporation and BellSouth Long Distance received based on Dun & Bradstreet's RAM

¹ BellSouth Direct Case, Exhibit 3 at 4.

credit scoring tool. In particular, BellSouth states that BellSouth Corporation received a RAM credit score of 5.3, and that BellSouth Long Distance received a credit score of 5.9. These results immediately raised red flags, because, as explained in the declaration of Dr. Cornell, BellSouth Corporation – a monopoly LEC – is substantially less likely to default on future bills than BellSouth Long Distance, which is a relatively new company operating in a highly competitive market.

10. Because BellSouth's purported results appeared to be inaccurate, I contacted a Dun & Bradstreet representative and requested that she provide the results of the RAM credit scoring tool for BellSouth Corporation and for BellSouth Long Distance (I could not do the run myself because AT&T does not use the RAM scoring tool). The Dun & Bradstreet representative informed me that it would be almost impossible to replicate BellSouth's results because the RAM scoring tool *requires* certain customized inputs and weighting factors, and has numerous other optional methods for customization.

11. For example, the Dun & Bradstreet representative explained that RAM users can choose to rely on various data including, among others, internal past payment data, third party past payment data, or data provided by Dun & Bradstreet. RAM users also must set several weighting factors that determine how much each input affects the final credit score. As one example, a RAM user can set a high weighting factor for the inputs that denote prior defaults on payments to creditors. In so doing, the credit score will be more affected by prior payment defaults than it would if the weighting for that input were set at a lower level.

12. Because BellSouth has not made its customized RAM scoring tool available for public inspection, the Dun & Bradstreet representative agreed to provide the results for the

two BellSouth Companies generated by a version of the RAM scoring tool that the Dun and Bradstreet representative uses to demonstrate the tool to customers. The results are telling. According to the version of the RAM scoring tool used by the Dun & Bradstreet representative, BellSouth Corporation's RAM credit score is 1.50, while BellSouth Long Distance's RAM credit score is 0.86. These numbers are radically different from those reported by BellSouth, which confirms that the customization has a substantial impact on the outcome of the model. Notably, the RAM scores produced by the Dun & Bradstreet representative produced a higher credit score for BellSouth Corporation than it did for BellSouth Long Distance, which is more consistent with expectations.

13. In sum, BellSouth's claim that it is standard industry practice to make substantial deposit decisions based on the outcome of one or two credit scoring tools is not consistent with my experience. In addition, BellSouth's claim that the credit scoring tools are objective is not true – those credit scoring tools are based on several subjective customizations.

VERIFICATION PAGE

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

/s/ Raymond E. Blatz

Raymond E. Blatz

Executed on October 23, 2002.